Non-Bank Financial Institutions

Nicola Cetorelli

Community Depository Institutions Advisory Council

The views expressed are those of the speakers, and do not necessarily reflect the position of the New York Fed or the Federal Reserve System.
Three main objectives

- Definition of Non-Bank Financial Institutions (NBFIs)
- Factors behind the growth of NBFIs
- Why do NBFIs matter for the Fed?
NBFIs as financial “Go-Between”

“Textbook” Financial Intermediation

Investors → Banks → Capital Users

“Modern” Financial Intermediation

Investors →
Banks
Money Market Funds
Bond/Equity Funds
ETFs
Hedge Funds
Pension Funds
Insurance Companies
Securities Brokers and Dealers

Mortgage Companies
Credit Card Companies
Captive Finance
Private Credit Funds
Private Equity Funds
Real Estate Investment Trusts
Asset-Backed Securities Issuers
Payday Lenders

Capital Users →
NBFIs have outgrown banks

Source: Financial Accounts of the United States; U.S. Bureau of Economic Analysis
Multiple factors behind emergence of NBFIs

• Innovation

• Regulation / Regulatory arbitrage

• Institutional drivers
NBFIs affect monetary policy

• Traditionally, banks played primary role in of monetary policy actions to financial system and economy

• With NBFIs, heightened complexity of implementation and transmission of monetary policy
NBFIs impact financial stability

- Financial intermediation is risky. Banks heavily monitored and regulated, AND provided official backstops (deposit insurance and access to central bank liquidity)

- NBFIs not subject to prudential standards (or only limited), and no official backstops

- Historical examples:
  - Long Term Capital Management (LTCM) distress in 1998
  - Money Market Funds “breaking the buck” in 2008
  - Bear Stearns and Lehman, and AIG in 2008
  - Mutual Funds disruption in March 2020
NBFIs interconnected with Banks

- NBFIs do not operate in isolation
- Banks heavily interconnected with NBFIs
- NBFI distress can have impact on banks (example: Archegos in 2021)
Banks supply funding to NBFIs

Bank loans to NBFIs
$ Billion

Source: FR Y9-C. Consolidated Financial Statements for Holding Companies
Rise of nonbank mortgage lenders ...

Independent (nonbank) mortgage lenders originate the majority of loans

Source: HMDA. Figure courtesy of Karen Pence, Board of Governors, Internal Presentation
… but banks behind their growth

Nonbank lenders highly dependent on short-term “warehouse” lines of credit to finance originations

Source: NMLS Mortgage Call Report, Conference of State Bank Supervisors
Figure courtesy of Karen Pence, Board of Governors, Internal Presentation
NBFIs have also grown *inside* banks!

Subsidiary composition of Bank Holding Companies
1975 - 2023

Source: FR Y-10, Report of Changes in Organizational Structure
Takeaways

• Long list of NBFIs as important middlemen in financial systems

• Strong growth, and outgrowing of banking institutions

• Challenges to monetary policy in a more complex system with NBFIs

• NBFIs can be vectors of shock transmission and amplification in financial systems

• Banks’ growing exposures to NBFIs